Prepared Statement of Lloyd Day, Administrator
Agricultural Marketing Service
U.S. Department of Agriculture

Before the
House Committee on Agriculture
Subcommittee on Department Operations, Oversight, Dairy, Nutrition & Forestry
May 31, 2006

Mr. Chairman, good morning and thank you for the invitation to appear before the subcommittee today. Accompanying me is H. Paul Kyburz, Market Administrator for the Upper Midwest. My remarks will briefly highlight the general economic conditions facing U.S. agriculture, and then focus on the dairy industry here in the Upper Midwest.

The general economy continues to be strong with growth rates in 2006 expected to be similar to 2005, but below 2004. Increased energy costs, rising interest rates and high consumer debt loads are expected to result in slower, but still strong, domestic expenditures on food in 2006. U.S. exports, including agriculture products, are expected to grow with the decline in the value of the dollar. On May 9, 2006, the Department of Energy projected that 2006 diesel and natural gas prices will increase by 12 and 7 percent, respectively, over the 2005 increases of 33 and 19 percent, respectively. The costs of fertilizer, planting, harvesting, and drying will increase, and add about five cents per bushel to the cost of growing corn in 2006.

The dairy industry nationally has had two years of strong prices. Milk production continues to increase in response to near record milk prices in 2004 and 2005, restored

availability of rBst, and improved forage conditions. Milk production is forecast to be up nearly 3 percent in 2006, following a 3.3 percent increase in 2005. The production growth is coming primarily from the Western States on larger herds; as the number of dairy operators continues to decline nationally. This growth in production continues to exceed dairy product demand. USDA's May forecast estimated the all-milk price to average between $12.35 and $12.85 per cwt in 2006, down over 15 percent from 2005.

Dairy production costs are expected to be higher in 2006 than in 2005, primarily due to increased energy and feed costs. Corn is expected to average about $2.40 per bushel, $0.40 higher per bushel over last year, while soybean meal prices are expected to be about $170 per ton as compared to $175 in 2005.

USDA forecasts 2007 milk production growth to be less than 1 percent, with farmers responding to higher feed costs and lower milk prices in 2006. The 2007 all-milk price is forecast to increase an average between $12.85 and $13.85, up 6 percent over 2006, as the result of lower production growth coupled with a higher growth rate in demand.

The Commodity Credit Corporation (CCC) is currently purchasing nonfat dry milk from western states. USDA estimates net removals to be about 110 million pounds in 2006 and 195 million pounds in 2007. CCC has reduced burdensome nonfat dry milk inventories (over a billion pounds in Fiscal Year (FY) 2003 to less than 20 million pounds currently).

The Milk Income Loss Contract (MILC) Program was extended for 2 years (through August 2007) by the Deficit Control Act of 2005. MILC Program makes direct payments to dairy producers when the Class I price in Boston falls below $16.94 per cwt. MILC Program was originally authorized in 2002 and generated over $2 billion in direct payments to producers for FY 2002 thru FY 2005 production. Payments resumed under the MILC Program in April and were retroactive to December 2005.

International Markets Remain Firm

U.S. milk producers benefited in 2005 from tight world supplies of dairy products and a relatively weak U.S. dollar. Reduced milk production in New Zealand, Australia and the European Union limited supplies available for export and coupled with robust demand, 2005 international nonfat dry milk prices averaged 10-15 percent above 2004 levels. With world prices above the price support rate, the U.S. significantly increased exports of commercial milk powders. On the import side, lower U.S. butter and cheese prices resulted in import reductions of butter and American-type cheese compared to 2004.

U.S. Imports of Selected Dairy Products (mil. pounds)

	Butter and Butter Equiv. of Butter Substitutes	American Cheese	Cheese Other Than American	Milk Protein Concentrates	Casein
2001	82.3	68.6	368.1	78.1	135.8
2002	36.1	84.0	388.2	91.4	126.8
2003	33.2	68.0	408.6	106.4	153.1
2004	55.0	66.6	393.8	96.6	147.2
2005	42.9	40.2	392.4	121.3	153.9

Source: U.S. Census

U.S. Exports of Selected Dairy Products (mil. Pounds)

Exports	Butter and Butter Equiv. of Butter Substitutes	Cheese	Skim Milk Powder [1]
2001	8.4	115.4	211.8
2002	8.5	118.8	164.0
2003	25.5	114.9	249.9
2004	19.8	135.3	510.6
2005	18.9	126.8	610.8

Source: U.S. Census

[1] Includes milk powders with less than 1.5 percent butterfat

Similar trade conditions are shaping up for 2006. Global demand for dairy products remains firm, the U.S. dollar continues to be weak, and U.S. skim milk powder prices are expected to be competitive. Some weakening in world prices is likely as global supplies increase. U.S. commercial exports of skim milk powders are expected to continue, at lower levels than in 2005 as world price falls below support rate and some sales to CCC resume.

Milk Production Costs

Feed costs make up a substantial portion of dairy operating costs. USDA's Economic Research Service (ERS) estimates milk production costs for several dairy production regions. Wisconsin and a portion of Minnesota are in the Northern Crescent region that extends east to include Michigan and the Northeastern states. Northern Crescent feed costs averaged about 67 percent of total operating costs in 2003-04, as compared to 72 percent for the U.S. According to the ERS cost and return survey, Northern Crescent feed costs averaged about 42 percent of the milk price – which is the gross value of production of milk sold/cwt – for the same period, while in the U.S. feed costs averaged about 50 percent of the milk price.

Feed availability in the Upper Midwest appears to be good in 2006. Good weather conditions last summer and a mild winter have resulted in a sharp buildup in hay stocks and favorable moisture conditions this spring exist throughout the area.

The increasing cost of energy has created opportunities for agriculture as well, contributing to higher feed costs. Ethanol production this marketing year is expected to account for 14 percent of U.S. corn production. For the 2006/07 marketing year, corn used in ethanol is forecast to rise 550 million bushels, or 34 percent, to 2.15 billion bushels. Assuming corn acreage as reported in the USDA spring planting intentions survey and trend yields, ethanol would account for 22 percent of the 2006 corn crop. While increasing corn prices result in higher costs for conventional feed, ethanol offers new feed alternatives that dairy and other livestock farmers can take advantage of in the form of distillers grains and solubles (DGS).

Upper Midwest Dairy

Wisconsin and Minnesota milk production in 2005 was 31.1 billion pounds, about 18 percent of the 177 billion pounds of U.S. milk production. The two states' 1.7 million cows represented 19 percent of the U.S. dairy herd of 9.0 million cows. In 1995, Wisconsin and Minnesota milk production was 32.4 billion pounds, about 21 percent of U.S. milk production of 155.3 billion pounds. Wisconsin and Minnesota total milk production has fallen by about 4 percent since 1995, while U.S. production has increased by 14 percent. Over one-quarter of the nation's dairy operations are located in Minnesota and Wisconsin.

Milk Cows, Milk per Cow, Milk Production: Minnesota, Wisconsin, and U.S.

	Milk Cows	Milk per Cow	Milk Production	Licensed Dairy
	1,000 head	Pounds	Million Pounds	Operators
1995				
Minnesota	592	15,894	9,409	
Wisconsin	1,490	15,397	22,942	
MN & WI	2,082	15,538	32,351	
% of U.S.	22%	95%	21%	
U.S.	**9,466**	**16,405**	**155,292**	
2005				
Minnesota	453	18,091	8,195	5,800
Wisconsin	1,236	18,500	22,866	15,300
MN & WI	1,689	18,390	31,061	21,100
% of U.S.	19%	94%	18%	27%
U.S.	**9,041**	**19,576**	**176,989**	**78,295**

Source: USDA, NASS

The Upper Midwest Federal Milk Marketing Order regulates the processors and manufacturers who purchase a major share of Minnesota and Wisconsin milk, along with some milk from North and South Dakota, Iowa, and Illinois. In 2005, 22.4 billion pounds of milk was pooled on the Upper Midwest order (Federal Order 30), about 20 percent of the milk marketed through all 10 Federal orders. Two-thirds of the Upper Midwest milk was used in cheese, while about 20 percent was used for fluid milk products.

Cheese will continue to be the major use of milk in the Upper Midwest. However, growth in Western milk production and commodity cheese making capacity is shifting incentives for the Upper Midwest industry towards artisan cheeses and other value-added forms of dairy product production. The Wisconsin Specialty Cheese Institute and the Wisconsin Dairy Business Innovation Center are helping the shift in that direction.

Milk Price, Income Support, and the Farm Bill

With the 2007 farm bill on the horizon and the World Trade Organization (WTO) trade negotiations continuing, it can be expected that milk price and income support, along with the other farm programs, will receive attention in the months ahead.

The Milk Price Support Program (MPSP) supports milk prices at safety net levels by purchasing and storing dairy products (cheese, butter, and nonfat dry milk). Congress mandates a $9.90 per hundredweight (cwt) milk support level and the CCC calculates dairy product purchase prices that allow manufacturers to pay farmers that price for their milk on average. The Secretary may make changes twice per year to reduce costs in the relative nonfat dry milk, butter and cheese prices.

The Farm Service Agency has implemented the extended MILC Program to support dairy farm income. For the October 1, 2005, through August 31, 2007 period, a dairy farm operation's monthly payment will equal the eligible milk quantity sold in that month multiplied by 34 percent of the difference between $16.94 per cwt and that month's Boston Class I milk price. The 2002 Farm Bill originally set the payment rate factor at 45 percent.

As to the eligible quantity, the MILC Program caps milk eligible for payments at 2.4 million pounds per dairy farm operation. The purpose of the program is to mitigate the decline in small to mid-size dairy operations. Regions with more dairy operations receive a larger share of MILC Program payments than regions with fewer operations. Large dairy operations can attempt to receive a larger MILC payment by choosing a payment

month that they believe will have a higher payment rate. Wisconsin dairy farmers received 21 percent of the MILC payments while being home to 23 percent of all dairy operations. Similarly, Minnesota producers received nearly 8 percent of the MILC payments, as 9 percent of dairy locations are located there. Conversely, California, which has 3 percent of dairy operations, received 7 percent of all MILC payments.

Shares of Milk Production and MILC Payments

	Share of Dairy Operations	Share of MILC Payments
	Percentages	
California	3	7
Idaho	1	2
New Mexico	4	1
Minnesota	9	8
New York	10	9
Pennsylvania	13	9
Wisconsin	23	21

Based on expenditures under the original MILC program. The MILC Program is not expected to have a significant impact (<.2 percent) on total U.S. milk production.

The Dairy Export Incentive Program (DEIP) is an export subsidy program that allows exporters to bid for bonuses to enable export sales of butter, cheese, and nonfat dry milk. The program is currently inactive with the last subsidies paid in FY 2004. World market conditions are such that the U.S. price is the world price, and no bonus is needed to sell dry milk powders.

With these programs in mind, preparations for a new farm bill are now beginning. USDA held 52 forums throughout the country. Thousands of comments were received from the forums. The USDA has analyzed these comments and prepared 41 summary papers that are available on the USDA website. In addition, the Secretary recently

released the first in a series of analytical papers on risk management intended to provide factual information and facilitate discussion about the best policy approaches for the new farm bill. While there appears to be uncertainty surrounding when the actual farm bill debate will occur, USDA is preparing to be actively involved in the process.

Agricultural Marketing Service Activities

Finally, I would like to speak briefly about two of the programs of the Agricultural Marketing Service. The Federal milk marketing order program is one that continually changes to reflect relevant marketing conditions facing the dairy industry. Several regulatory decisions are in various stages of completion that relate to the Upper Midwest. The Fluid Milk Product Definition Recommended Decision affecting all 10 orders was issued this month proposing that Class I fluid milk products must contain greater than 6.5 percent nonfat milk solids and greater than 2.25 percent true protein. Drinkable yogurt, containing greater than 20 percent yogurt, is proposed to be in Class II. Public comments on this decision may be submitted through July 17.

The issue of Class III/IV Manufacturing Allowance levels used to calculate the value of milk was heard at a national hearing in January of this year. Post-hearing briefs were due February 17, 2006. Possible adjustments in the make (manufacturing) allowances in Class III and IV products are under consideration. The Department is analyzing the record.

Several hearings have been held for the Upper Midwest, Mideast, and Central orders that address pooling and re-pooling issues. Interim rules and recommended decisions have

been issued. Recommended decision comments were due April 24th for all three orders and final decisions are being prepared.

The Federal order rulemaking process has received significant attention recently by all sectors of the industry regarding the length of time involved to complete regulatory actions. AMS undertook an extensive internal review of the process and has developed several new rulemaking initiatives and customer service standards. Our goal is to improve timeliness and transparency while at the same time maintaining the opportunity for public involvement that currently exists. Through this initiative, AMS expects to improve non-emergency rulemaking timeliness by reducing the time required to complete regulatory actions by over one-third.

AMS also oversees the operations of the National Dairy Promotion and Research Program and the National Fluid Milk Processor Promotion Program. As fluid per capita consumption of fluid milk products continues to decline, these programs are proving to be a very positive force in the development of markets for milk and dairy products. In 2005, producers contributed more than $260 million and processors contributed about $105 million to be spent on a variety of activities to expand the markets for fluid milk and dairy products. Among the most important is the effort to provide the products consumers demand. One such effort, the promotion of single-serve milk in plastic bottles for schools and in restaurants is expected to add over a billion pounds of milk to fluid sales. Dairy Management Inc. (DMI) has become partners with several restaurant chains to increase their sales of fluid milk. Thus far, during the initial launch in 20,000 restaurants, combined weekly average milk sales have grown exponentially. More

restaurants will have national rollout of the single-serve containers in June. In addition to milk, the National Dairy Promotion Program is partnering with a fast food chain to test and market a 7-ounce strawberry yogurt cup that is now a permanent menu option. This introduction helped lead to a 7 million pound annual increase in milk used through foodservice.

Conclusion

In conclusion, although the U.S. dairy industry is experiencing a year of reduced prices after two years of all-milk prices averaging $15.45 per cwt., prices are forecast to increase in 2007. Milk prices in the Upper Midwest are moving with U.S. prices. The MILC program has been extended, and will provide payments to farmers up to the 2.4 million pound milk production cap. The demand for milk continues to be strong domestically and for exports of skim milk powders. The Upper Midwest dairy industry continues to be a major supplier of milk and dairy products to U.S. consumers and a major positive factor in the region's economy, drawing on institutions such as the Wisconsin Specialty Cheese Institute and the Wisconsin Dairy Business Innovation Center, and its innovative cooperatives and cheesemakers.

This concludes my statement, Mr. Chairman. I would be pleased to respond to questions.